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Supreme Court of the United States

OCTOBER TERM, 1932.

No. 732

RICHARD REID ROGERS,
Petitioner,
against
GEORGE W. HILL, A. C. MOWER, CHARLES A. PENN, C. F. NEILEY, V. RICCIO and THE AMERICAN TOBACCO COMPANY,
Respondents.

RICHARD REID ROGERS,
Petitioner,
against
THOMAS R. TAYLOR and THE AMERICAN TOBACCO COMPANY,
Respondents.

Consolidated Cause.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

RICHARD REID ROGERS,
Petitioner, pro se.

EVAN SHELBY,
of Counsel.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Statement.

This is a consolidation of two representative actions, both of which involve the same issues: (1) the validity of a

by-law, known as By-Law XII, adopted by the stockholders of The American Tobacco Company in 1912 whereby 10 per cent. of the net profits of the company over and beyond the sum of $8,222,245.82 (the estimated amount of net profits for 1910) were made payable 2½ per cent. to the president and 1½ per cent. to each of the five vice-presidents (R. pp. 61, 62); and (2) the question whether, if the by-law were valid, the other largely increased fixed salaries, and special compensations voted these officers by the directors, amounting to twice again as much as the profit distribution, did not render the total compensation payable to these officers unreasonable and exorbitant, and, therefore, under a well recognized principle of equity, subject to revision by the courts.

The original action was instituted March 30, 1931, in the Supreme Court of New York, The American Tobacco Company having declined to sue (R. p. 61), against that company, the president, Hill, and Penn, Neiley, Riggio and Mower, four of the five vice-presidents, all except Penn being citizens of New York. This action was removed to the United States District Court for the Southern District of New York by The American Tobacco Company of New Jersey and Penn of North Carolina upon the ground that it involved a separable controversy as to them. A motion to remand was denied November 6, 1931 (*Rogers* v. *American Tobacco Co.*, 53 Fed. [2d] 395). The second action was originally instituted in the United States District Court for the Southern District of New York May 28, 1931, by the petitioner, a citizen of New York, against The American Tobacco Company and Taylor, both citizens of New Jersey, on the ground of diverse citizenship (R. p. 2). On November 24, 1931, the two actions were consolidated, and it was ordered that the amended complaint in the first, or Hill action, should likewise serve as an amended complaint in the Taylor action; and that the answer filed in the Hill action should be deemed an answer in the Taylor action. The detailed facts set up in the amended complaint were ascertained as the result of an examination of

the company's books, contested as far as the Court of Appeals of New York (*Rogers* v. *The American Tobacco Co., Matter of,* 143 N. Y. Misc. Rep. 306, 309; 233 App. Div. 708), and were required to be set up either in a bill of particulars or amended complaint by order of the District Court (R. p. 113), so that the full facts might be presented by the pleadings, and the trial of the cause shortened.

The defendants having failed to move, the petitioner brought the matter on by a motion to (1) strike out the affirmative defenses for insufficiency, (2) for a decree upon the pleadings declaring the By-Law XII invalid, and for an accounting, or, (3) in the alternative, for an order enjoining The American Tobacco Company *pendente lite* from making any further payments under the by-law (R. p. 6).

On March 17, 1932, the District Court (Caffey, J.) handed down a decision, in which he stated that he was persuaded that the bill stated a cause of action, that he was bound to exercise jurisdiction, and that his present impressions were that the by-law was invalid and the defenses insufficient: but that it was desirable to obtain from the Circuit Court of Appeals an early authoritative ruling on the by-law and the separate defenses. He therefore confined his ruling to a single matter, i.e., the granting of an injunction *pendente lite*, restraining the tobacco company from making further payments under the by-law, reserving all other questions until the matter had been passed upon by a higher court (R. pp. 211-213). An order to this effect was entered (R. p. 214); the petitioner executed the bond required; and the defendants appealed from this interlocutory order to the Circuit Court of Appeals. The Circuit Court of Appeals, by a majority vote (Manton and Chase, JJ.; Swan, J., dissenting), reversed the order granting the injunction *pendente lite*. The mandate so provided, and nothing further (R. p. 241). The Circuit Court of Appeals, on a petition for rehearing, refused to further clarify the extent of its decision, and upon the coming down of the mandate, and upon the

mandate alone, without any further hearing, the District Court (Mack, J.) dismissed the entire case upon the merits (R. p. 243). Upon the second branch of the case, whether if the payments under the by-law were valid the total compensation received by the officers was excessive, the petitioner has never had his day in court.

From the final judgment on the mandate the petitioner appealed to the Circuit Court of Appeals; and on February 6, 1933, the decree below was affirmed on the authority of the opinion on the appeal from the interlocutory order (*Rogers* v. *Hill,* 60 Fed. [2d] 109). Judge Augustus Hand concurred on the authority specified in the *per curiam* opinion, saying, however, "With the matter open I should reach a different decision" (R. p. 253).

The petitioner to-day therefore stands in this singular case, that of the five Federal Judges who have passed upon the merits of his cause, three, to wit, Caffey, District Judge, Swan and Augustus Hand, Circuit Judges, have expressed the opinion that the complaint sets forth a cause of action, and inferentially, at least, that the separate defenses are insufficient. Two only, Manton and Chase, Circuit Judges, have decided against him; but their decision controls.

Up to the present time it has not seemed that the petitioner, under the orderly processes of the law, was in a position to apply for a writ of certiorari. The first decision merely reversed an interlocutory order and dissolved an injunction *pendente lite,* a discretionary matter. From reading the majority opinion, it was impossible to determine whether the intention was to dispose of the question of excessive salaries. The burden to support them was on the defendants (*Booth* v. *Land Co.,* 68 N. J. Eq. 536; *Davis* v. *Thomas,* 63 N. J. Eq. 572; *Gardner* v. *Butler,* 30 N. J. Eq. 702; *Schall* v. *Althaus,* 208 App. Div. 103, 106). A final decree having now been entered, and the petitioner having exhausted his remedies in the lower courts, the time seems appropriate to present this petition for a writ of *certiorari.*

There has been no change in the parties since the institution of this litigation, except that the defendant Charles A. Penn died October 22, 1931. A motion to revive the consolidated action against his executors was made, opposed and submitted, and is still held under advisement by the District Court. Service upon Mower has not been obtained.

Facts.

The central facts are as follows:

The American Tobacco Company was organized by merger in 1905, under a charter which contained the following provisions:

> "The directors of said merged corporation shall have the power to fix and determine from time to time and to vary the sum to be reserved, over and above its capital stock paid in, as a working capital, before declaring any dividends among its stockholders, and to fix the time of declaring and paying any dividend, and the amount of any dividend shall be determined by the directors, unless otherwise provided by the by-laws of the corporation; and to direct and determine the use and disposition of any surplus or net profits or earnings, over and above the capital stock paid in. All sums so reserved may be applied from time to time to the acquisition of property as the directors shall from time to time determine" (R. pp. 30-31).
>
> * * * * * *
>
> "The power to make and alter by-laws of said merged corporation is conferred upon the directors" (R. p. 30).

Notwithstanding these provisions, at the annual meeting of the stockholders March 13, 1912, the stockholders adopted the following by-law, known as By-Law XII, the first and important section of which reads as follows:

> "SECTION 1. As soon as practicable after the end of the year 1912 and of each year of the Company's operations thereafter, the Treasurer of the Company

> shall ascertain the net profits, as hereinafter defined, earned by the Company during such year, and if such net profits exceed the sum of $8,222,245.82, which is the estimated amount of such net profits earned during the year 1910 by the business that now belong to the Company, the Treasurer shall pay an amount equal in the aggregate to ten per cent of such excess to the President and five Vice-Presidents of the Company in the following proportions, to wit: one-fourth thereof or 2½ per cent of such amount to the President; one-fifth of the remainder thereof, or 1½ per cent of such amount to each of the five Vice-Presidents as salary for the year, in addition to the fixed salary of each of said officers" (R. pp. 61-62).

Under this by-law there was paid to the defendant Hill, vice-president to April 6, 1926, and president thereafter, from $89,833.94 in 1921 to $842,507.72 in 1930 (R. p. 16). On January 2, 1932, although the accounts for the year had not been made up, there was paid to the president, as appears from the affidavit of the treasurer (R. p. 210), on account for the year 1931, $850,000. The payments to the senior vice-president, Penn, ran as high as $505,504.63 in 1930, and higher still in 1931. The payments to the junior vice-presidents were in proportion, and are set out in detail at the pages above referred to.

In addition to this profit sharing, the president received, by a vote of the directors, the following fixed annual salaries: To and including the year 1928, $75,000; for the year 1929, $144,500; for the year 1930, $168,000. In addition, he was voted by the directors for the year 1929 a cash credit of $136,507.71, and for the year 1930, $273,470.76. The first vice-president, Penn, received a fixed salary until 1929 of $45,000; in 1929 of $81,166.66; and in 1930 of $98,000. His cash credits for 1929 and 1930 were $90,702.81 and $181,708.12, respectively. The increase in salaries and credits to the other vice-presidents, except Taylor, were proportionate (R. p. 14). In addition, in 1931, the directors, who were themselves receiving a part of the stock on similar terms (see *Rogers* v. *Guaranty*

Trust Co., 53 Sup. Ct. Rep. 295), voted these officers, the individual defendants, shares of common stock B at $25 a share, when it had a market value of $112 a share, "by way of additional compensation for services to be rendered" from January 28 to December 31, 1931, as follows: To defendant Hill, 13,440 shares; to Penn, 8,025 shares; to Riggio, 4,000 shares; to Neiley, 3,000 shares; to Mower, 1,000 shares (R. p. 15); to Taylor, it was alleged on information and belief, 3,000 shares (R. p. 186); actually, when the facts were ascertained definitely, he was found to have received under 1,000 shares. While the legality of these payments is contested, they are all claimed to be valid by the defendants. Valuing the stock compensation for 1931 at the difference between purchase price and market and adding all other compensations, the total received by Hill in 1931 was approximately $2,627,978.48; by Penn, $1,587,712.75; by Mower, Neiley and Riggio, from $746,358 to $950,349 (R. p. 19).

While these increases in payments were running on, the stockholders were adding additional capital to the company. In 1929 they added $48,822,875 by subscription to 390,583 shares of common stock B created in 1920 (R. p. 18); and from the time of the adoption of By-Law XII to the time when the amended complaint was filed, contributed approximately $113,000,000 from surplus earnings.

The petitioner became a shareholder of common stock in 1917 and of common stock B in 1925, but had no actual knowledge of the profit distribution until litigation was begun; no disclosure of payments thereunder ever having been made by the company (R. p. 20).

Before presenting the reasons for the allowance of the writ, it may be appropriate, in view of the decision of this Court in *Rogers* v. *Guaranty Trust Co.*, to make the following observations concerning the

Jurisdiction of the Federal Courts in the Present Case.

All other questions apart, this case would seem to be one where under any circumstances the law of the *forum non conveniens* should not apply. While, of course, upon some of the questions which arise a reference to New Jersey statutes and decisions becomes important, the principal points presented involve questions of general law; as, for example, whether the charter contract of stockholders *inter sese* did not forbid a distribution of company profits to officers; whether the funds distributed were in fact a part of the profits; whether the stockholders were qualified to pass a by-law after having conferred that power by the express provision of the charter on the directors; whether a case has been presented for equitable revision of salaries; whether the petitioner has been denied due process of law by refusing him a hearing upon this important question. Very little reference to New Jersey law is necessary for the determination of these questions of general jurisprudence; and, moreover, where necessary, the law seems settled.

Moreover, a direct recovery of past payments as well as an injunction against future payments is sought of the principal individual defendants, most of whom are residents of New York, and could not be reached in New Jersey. Nor is there any *res* in New Jersey, as in the case of a stock issue such as was before the Court in *Rogers* v. *Guaranty Trust Co.*, which might afford relief against this situation. In truth, to send the petitioner into New Jersey would be to deny petitioner in effect all right of recovery for past payments, no matter how clear that right may be, and thus defeat justice, as it cannot be assumed the principal defendants would voluntarily subject themselves to the New Jersey Courts. There can be no doubt that under the authority of the leading case of *Ernst* v. *Rutherford*, 38 App. Div. 388, approved *in extenso* in *Miller* v. *Quincy*, 179 N. Y. 294, 301, the New York Courts, from which the *Hill* suit

was removed by certain defendants, would have retained jurisdiction of the cause. Similarly in New Jersey, as appears from the recent decision of Vice-Chancellor Bigelow in *Mayer* v. *Oxidation Products Co.*, 110 N. J. Eq. 141, where all the authorities are elaborately reviewed, the New Jersey courts would retain jurisdiction of an action such as this if brought there against a foreign corporation. The principles laid down in those cases would seem to be equally applicable in the Federal Court.

Apart from this general question, there are two special reasons why these cases should not be sent into New Jersey.

First: The Taylor action was originally brought in the Federal Court on the ground of diverse citizenship. Although it turned out that Taylor has actually received no payments under By-Law XII, he is potentially entitled to payment, and that action raises the same question against The American Tobacco Company as is raised against it in the *Hill* action, with which it was consolidated. The case therefore seems to be one, at least so far as the *Taylor* action is concerned, where the petitioner's constitutional right to resort to an impartial tribunal, to wit, a Federal Court, rather than the courts of the state of the corporate defendant is assured. As said in *Hyde* v. *Stone*, 20 How. 170, 175, the Federal Courts are bound to afford redress to suitors in every case to which their jurisdiction extends:

> "They cannot abdicate their authority or duty in any case in favor of another jurisdiction."

See also:

Suydam v. *Broadnax*, 14 Pet. 67, 75;
Cohen v. *Virginia*, 6 Wheat. 264, 404;
Chicot v. *Sherwood*, 148 U. S. 529, 534;
McClellan v. *Carland*, 217 U. S. 268, 281;
Kline v. *Burke*, 260 U. S. 226, 230;
Canada Malting Co. v. *Paterson Steamships*, 285 U. S. 413, 422.

SECOND: The District Court, even if it had discretion in these cases, exercised it in favor of retaining jurisdiction and not in rejecting it; and according to *Rogers* v. *Guaranty Trust Company* it would seem that it is the discretion of the District Court which controls.

Petitioner presents the following

Reasons for Allowance of the Writ.

REASON I. Inasmuch as the charter of the company provided in effect that profits (1) could only be put into a reserve fund to be invested by the directors in property, or (2) be used to pay dividends, a distribution of these profits to officers, in addition to their fixed salaries, was a violation of the charter contract of the stockholders *inter sese,* which cannot be continued over the objection of a single stockholder. The holding of the majority of the Circuit Court of Appeals to the contrary is believed to be opposed to the decisions and statutes of New Jersey on an important question of local and general law and to the decisions of this Court on an important question of general law as well.

REASON II. The stockholders by the charter having delegated to the directors the entire authority to adopt by-laws were void of authority to adopt By-Law XII. The decision of the Circuit Court of Appeals to the contrary is believed to be opposed to an overwhelming weight of authority upon an important question of general law.

REASON III. The District Court granted an interlocutory order restraining The American Tobacco Company from making any further payments under By-Law XII until the case could be heard. The decree and the mandate of the Circuit Court of Appeals merely reversed this discretionary order. Without further hearing, on the mandate alone, the District Court thereupon entered a final decree dismissing the complaint upon the merits; and this final decree has now been affirmed by the Circuit Court of Appeals. Petitioner has never had a hearing

upon the second branch of his case, viz.: that if the payments under the by-law were valid, then the total compensation voted these officers, of which two-thirds was voted solely by the directors, was excessive and subject to equitable revision; and therefore has been denied due process of law.

REASON IV. Contemporaneously with the payments under By-Law XII, the directors increased the fixed salaries and voted additional special credits and stock benefits "as additional compensation" to the individual defendants and officers, amounting in 1931 to twice as much as the payments under the by-law. After the by-law was passed the stockholders also contributed $113,000,000 additional capital to the company, materially changing the equities between the stockholders and the officers as of the date of the by-law. In denying petitioner the right under these circumstances to have the total salary payments reviewed in equity, to determine whether they were unreasonable, the Circuit Court of Appeals decided against petitioner an important question of general law contrary to the great weight of authority.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari issue to review the decree entered in the United States Circuit Court of Appeals for the Second Circuit on the 14th day of February, 1933, in the above-mentioned consolidated action, entitled in said Court "Richard Reid Rogers, Plaintiff-Appellee, against George W. Hill, A. C. Mower, Charles A. Penn, C. F. Neiley, V. Riggio and The American Tobacco Company, Defendants-Appellants; Richard Reid Rogers, Plaintiff-Appellee, against Thomas R. Taylor and The American Tobacco Company, Defendants-Appellants; Consolidated Cause."

Respectfully submitted,

RICHARD REID ROGERS,
Petitioner.

EVAN SHELBY,
of Counsel.

BRIEF IN SUPPORT OF PETITION.

REASON I.

Violation of Charter by By-Law XII.

A charter of course is recognized as a contract everywhere, but no state has gone farther in that regard than New Jersey. There the charter is not only a contract between the stockholders *inter sese,* but the contract may not be changed, except as to those matters which concern the public, by subsequent legislation, notwithstanding a reserved power to amend (*Kean* v. *Johnson,* 9 N. J. Eq. 401; *Zabriskie* v. *Hackensack Ry. Co.,* 18 N. J. Eq. 178, 191, 192; *Black* v. *Del. & Rar. Canal Co.,* 24 N. J. Eq. 456; *Mills* v. *The Central R. R.,* 41 N. J. Eq. 1; *Lowenthal* v. *Rubber Co.,* 52 N. J. Eq. 440, 441; *German Ins. Co.* v. *Schwarzwaelder,* 59 N. J. Eq. 589; *Re Newark Library Assn.,* 64 N. J. L. 217, 219; *Einstein* v. *Raritan Woolen Mills,* 74 N. J. Eq. 624, 629; *Itiso* v. *Met. Sav. & Loan Co.,* 68 N. J. L. 588, 590; *Colgate* v. *U. S. Leather Co.,* 75 N. J. Eq. 229, 239; *Riker* v. *United Drug Co.,* 79 N. J. Eq. 580, 583).

The provisions of the charter upon which petitioner relies are set out at page 5 of the petition. These provisions are enumerated in the charter itself under the head of "Limitations of Powers" (R. p. 28). It is the petitioner's contention that under those provisions the profits of the company can be applied only (1) to put into a reserve fund to acquire property as directed by the board, or (2) to the payment of dividends. Evidently this limitation of powers implies the exclusion of all others; particularly of the right to dispose of profits for any other than the specified purposes (*Central Transportation Co.* v. *Pullman Car Co.,* 139 U. S. 24, 48; *Somerville Water Co.* v. *Somerville,* 78 N. J. Eq. 199, 212).

In this connection, the language of the Court of Errors and Appeals of New Jersey in *Riker* v. *United Drug Co.*, 79 N. J. Eq. 580, 583, and of this Court in *Dodge* v. *Woolsey*, 18 How. 331, 341, 342, is particularly applicable.

In the *Riker* case, the Court of Errors and Appeals said:

> "Each stockholder of the company owns a share in its property and assets, and is entitled to have a proportionate share in its profits. They have invested their capital in it, and in it alone, and they are entitled to every dollar that it earns. This is the agreement of the stockholders among themselves. They each contract with the other that their money shall be employed for the purposes specified in the certificate of incorporation, and for no other purpose, and that the profits of the enterprise shall be ratably apportioned among them. In the absence of legislation permitting a variation of the provisions of this fundamental contract, by vote of a majority of the stockholders, no majority, however large, has the right to divert any part of the joint capital, however small, to any purpose not consistent with and growing out of this original, fundamental agreement" (citing *Black* v. *Del. & Raritan Canal Co.*, 24 N. J. Eq. 456, 463; *Mills* v. *Central Railroad Co.*, 41 Eq. 1; *Colgate* v. *U. S. Leather*, 75 Eq. 229).

Compare *Park* v. *Locomotive Works*, 40 N. J. Eq. 114, 119, where a contract provided that the "net profits" should be divided between the stockholders, and it was held that the directors had no right or judgment, but must perform the contract obligation.

In *Dodge* v. *Woolsey*, this Court, after observing that courts of equity have jurisdiction to prevent any misapplication of funds of a corporation "which might result in lessening the dividends of stockholders" even "though the misapplication be sanctioned by a vote of the majority," went on to say:

> "But further, it is not only illegal for a corporation to apply its capital to objects not contemplated by its charter, but also to apply its profits. And

> therefore a shareholder may maintain a bill in equity against the directors and compel the company to refund any of the profits thus improperly applied."

Now the majority opinion does not expressly dispute the construction of the charter, which to the petitioner seems so obvious. The opinion of Judge Swan, dissenting, states positively: "If it was really a distribution of profits rather than a method of compensation, the majority stockholders had no power to vote it" (R. p. 236). The majority attempts to meet the provisions of the charter by the following argument: "Compensation to officers of a corporation is an operating expense of the company, whether at a fixed salary or based upon a percentage of the profits, and until such expenditures are met there are no net profits of the corporation. It is the sum beyond this which constitutes the surplus, net profits or earnings referred to in this corporation's charter" (R. p. 229).

That what was distributed to the officers under By-Law XII, however, was in fact a share of the net profits, and not an expense item, as was their fixed salaries, appears (a) from the language of the notice to stockholders soliciting proxies for the meeting; (b) from the language of the By-Law itself, and (c) from the company's practice thereunder.

(a) In the notice sent out to the stockholders, it was distinctly stated:

> "At this meeting there will be presented for consideration, and action upon, a proposed by-law providing *for participation by certain officers of the company* IN PROFITS, if any, earned by the company in excess of profits earned during the year 1910 on the brands and businesses now owned by the company, not exceeding in the aggregate 10% of such excess" (R. p. 26).

The language of this notice, upon which proxies were solicited, is of great importance. It in effect limited the business to be transacted to the matter set out in the notice,

i. e., profit sharing, and not salary increase. Proxies could not be properly voted for any other than the noticed purpose (*Wall* v. *Utah Copper Co.*, 70 N. J. Eq. 17, 24). See also *Schwarzwalder* v. *Tegen*, 58 N. J. Eq. 319, 325, and *Scott* v. *Lorillard*, 108 N. J. Eq., at page 160, affirmed by the Court of Errors and Appeals on the opinion below, 109 N. J. Eq. 417. See also *Rogers* v. *Guaranty Trust Co.*, 53 Sup. Ct. Rep., at pp. 300, 302.

(b) The by-law itself is equally explicit as to profit distribution. It says (R. p. 23):

> "As soon as practicable after the end of the year 1912 and of each year of the Company's operations thereafter, the Treasurer of the Company shall ascertain *the net profits, as hereinafter defined,* earned by the Company during such year, and if such net profits exceed the sum of $8,222,245.82, which is the estimated amount of such net profits earned during the year 1910 by the businesses that now belong to the Company, the Treasurer shall pay an amount equal in the aggregate to ten per cent. of such excess to the President and five Vice-Presidents of the Company in the following proportions."

The profits "hereinafter defined" are described in Section 3 (R. p. 62) to "consist of the net earnings made by the Company * * * *after* deducting all expenses and losses" plus depreciation and dividends on the preferred stock.

(c) In the accounting of the company, the bonus payments are likewise treated as profit distribution and not as an expense. The officers' percentage of the profits is calculated, not on the sum which remains *after* deducting the officers' 10 per cent. as a *previous* expense, as in the case of the true salaries, but upon the sum which remains *before* the 10 per cent. is deducted (see plaintiff's affidavit, R. p. 11; Defts.' Ex. A, R. p. 110). This is apparent from the figures showing the additional payment made defendant Hill for 1930, to wit, $842,507.72 (R. p. 16). This

was 2½ per cent. of the net profits over and beyond $11,369,000, or 2½ per cent. of $33,700,156. Had this additional payment been treated as an expense in the same sense as the fixed salary, it would have been calculated upon the sum left over *after* deducting it, and would therefore have been approximately 9 per cent. less than the amount Hill actually received, or $765,685, instead of $842,507.72. The other bonuses would have been reduced in the same proportions.

It is therefore impossible to consider the profit distribution an *expense* in the sense that a fixed salary was an expense, and to call it "salary for the year" does not change its essential character. As said in *Godley* v. *Crandall*, 212 N. Y., at page 127, in a parallel situation, "the amounts were paid at the end of each year from surplus profits."

It is evident therefore that what has been done in this case is a diversion of profits by way of bonuses to corporate officers, and this could not be done without the consent of every stockholder. Even if it could be said that such a proceeding was binding on a stockholder who voted for it, it could not have been binding on those who did not attend the meeting (*Kessler* v. *Ensley Co.*, 129 Fed. 397, 417; *Matter of Empire State*, 53 Misc. 344, 352; *Douglass* v. *Concord R. R.*, 72 N. H. 26, 31); and certainly not upon the great body of the holders of common B nonvoting stock, which was only created in 1920, and of which the plaintiff is the registered holder of 400 shares (R. p. 12).

Evidently the Legislature of New Jersey, which cannot be presumed to have done a vain or unnecessary act (*Sutherland on Statutory Construction*, Secs. 497, 499), had no idea that profit sharing was legal in 1912, for in 1920 it passed Chapter 175, Laws of 1920 (*Smith on N. J. Corp.*, p. 123) authorizing for the first time profit sharing; although from an examination of that law it would seem that the Legislature had in mind a general profit sharing among all employees, the words "any or all" employed in statutes of this kind being generally considered to have a broad distributive meaning (3 *C. J.*, p. 232).

But the important statute in this connection is the Act of 1932, Chapter 192, amending Chapter 175, Laws of 1920, as indicated by the words in italics:

> "The privileges and powers conferred by this Act shall be deemed to be in addition to and independent of any and all powers and authority conferred by any other law or laws, and not in restriction as limitation of the powers now permitted to corporations of this State. *A resolution or by-law heretofore adopted by a majority vote of the stockholders of a corporation entitled to vote thereon shall be valid from the time of such adoption or approval to the extent it contains terms which might be embodied in a plan or plans authorized by this Act as amended.*"

It is evident on the face that this so-called curative act was introduced and passed to meet the very situation developed by this litigation. No Legislature on its own motion would go so far out of its way to pass an act of such limited application. The Act, however, as remedial legislation is plainly unconstitutional. It violates both the Constitutions of New Jersey and of the United States.

The Constitution of New Jersey contains the following provision (Art. 4, Sec. 7, par. 3):

> "The legislature shall not pass any * * * law impairing the obligation of contracts, or depriving a party of a remedy for enforcing a contract which existed when the contract was made."

Similarly Section 5 of the General Corporation Act (Smith, p. 74) provides as follows:

> "This act may be amended or repealed, at the pleasure of the legislature, and every corporation created under this act shall be bound by such amendment; but such amendment or repeal shall not take away or impair any remedy against any such corporation or its officers for any liability which shall have been previously incurred; this act and all amendments thereof shall be part of the charter of

> every corporation heretofore or hereafter formed hereunder, except so far as the same are inapplicable and inappropriate to the objects of such corporation."

Commenting on this matter, it has been said in New Jersey (*Rader* v. *Southeasterly Rd. Dist.*, 36 N. J. L. 273, 280) that any legislation, the effect of which is to deprive a party of the power to resort to the person or any property, which as the law was when the contract was made might have been taken or applied in satisfaction of his demand, is within the prohibition of the constitution prohibiting the passage of any law depriving a party of any remedy for enforcing a contract which existed when the contract was made; it being added that the very purpose of the insertion of this clause in the Constitution of 1844 was to meet the previous decisions of this Court drawing a distinction between the obligation of a contract and the remedies thereunder.

If it were possible to get by the Constitution and laws of New Jersey with this retroactive special legislation, it would be stopped by the contract clause of the Federal Constitution.

The Act of 1932, however, performs a very useful function in the determination of the question now under discussion. It plainly shows that there was no law in existence in 1912 which could have authorized By-Law XII; for why resort to legislation to validate what was already valid? The implication of original invalidity is manifest; and, as the invalidity rests upon a plain charter limitation, no subsequent legislation could cure it in any event.

In conclusion, it will be noted that this futile act speaks of a by-law adopted by a vote of stockholders "entitled to vote thereon"; and this brings us to

REASON II.

The stockholders by an express provision of the charter having delegated to the directors the power to adopt by-laws, lost all power to adopt By-Law XII.

The charter, it has been observed, expressly conferred on the directors the authority to make and alter by-laws (R. p. 30).

This provision in the charter was inserted by authority of the General Corporation Act of New Jersey (Laws of 1896, Chap. 185, Sec. 11; Smith, p. 184), which provided:

> "The power to make and alter by-laws shall be in the stockholders, but any corporation may, in its certificate of incorporation, confer that power on the directors; by-laws made by the directors under power so conferred may be altered or repealed by the stockholders."

The authorities are uniform that where the charter contains such a provision the stockholders cannot enact a valid by-law.

In *Fletcher on Corporations*—the latest textbook on the subject—it is said (Sec. 4172):

> "The charter of the corporation may expressly vest such power [adoption of by-laws] in the governing board and when this is done, the by-laws, of course, must be adopted not by the stockholders or members, but by such board."

By-laws enacted by the stockholders in such case

> "are lacking in validity, or legal force and effect" (*id.*).

To the same effect is *Thompson on Corporations*, Section 1069, and *Corpus Juris*, Volume 14, page 353, Section 447.

See also, expressly in point:

Mfg. Bldg. Co. v. *Landay*, 219 Ill. 168, 174, 177;
People v. *Ittner*, 165 Ill. App. 360, 365;
Indiana ex rel. v. *Day*, 189 Ind. 243, 247;
In re Klaus, 67 Wisc. 401, 405;
Kaski v. *Kemppainen*, 110 Ore. 362, 367;
The King v. *Westwood*, 4 Barn & Cress. 781, 788;
Dunsmuir v. *Colonist Co.*, 9 Br. Col. 290, 293;
Colonial Ass. Co. v. *Smith*, 22 Man. 441, 445;
Kelly v. *Electrical Cont. Co.*, 16 Ont. 232, 239.

In the recent case of *Scott* v. *Lorillard*, 108 N. J. Eq. 153, 155, the same conclusion was reached on a consideration of the general corporation laws of New Jersey alone. The Vice-Chancellor said:

> "The stockholders may, of course, choose directors who will act in accord with their wishes. They may limit the authority of the latter pursuant to Section 8 (VII) but they cannot usurp the powers of the Board. Lowenthal v. Rubber Reclaiming Co., 52 N. J. Eq. 446; Plaquemines Tropical Fruit Co. v. Buck, 52 N. J. Eq. 219. It should be noted that the directors have not formulated or approved the proposed by-law."

The Court of Errors and Appeals thought this statement unnecessary to the decision, and expressed no opinion on it one way or the other. It did not appear, however, in the *Lorillard* case that the power to pass by-laws had been delegated by the charter to the directors, as was done in the case at bar.

No majority of stockholders could impose a profit-sharing arrangement upon the minority stockholders in any form; but least of all by passing a by-law as to which the stockholders were *functus officio*. The sole power of the corporation toward its employees in this regard was confined to paying "suitable compensation" (G. C. A., Sec. 1-V; Smith, p. 96), and this was a matter of corporate management left to the directors to be reasonably exercised, subject to the ordinary liability of trustees for an abuse of power.

The point here is by no means technical. It is the unquestioned law in New Jersey, as nearly everywhere else, that corporate management resides solely with the directors. With this duty goes a corresponding obligation to the shareholders to administer the affairs of the company with wisdom and economy. The by-law, particularly as it in terms provided that it could only be repealed by action of the stockholders, relieved the directors of this fiducial responsibility. The bonus payments became enormous; certainly the $113,000,000 of new money that the stockholders contributed subsequently to the passage of this by-law, as well as the large increases in fixed salaries, and the other special benefits referred to at pages 6 and 7 of the petition, justified, if it did not demand, the reconsideration of this by-law by the directors in the exercise of sound administration. But the by-law absolutely disqualified them from the performance of this most elementary duty.

This exact point was raised in *Berendt* v. *Bethlehem Steel Corp.*, 108 N. J. Eq. 148, 149, 152, where the Court approved inferentially the charge made in that case that "though the stockholders fixed the percentage of bonus, it became the duty of the board of directors, whenever the bonus became excessive, to modify it to a basis of reasonable compensation * * * as they were in conscience bound to do."

It will be observed that the by-law provided as follows:

> "This By-Law may be modified or repealed only by action of the stockholders of the company and not by the directors."

How could the stockholders, especially in view of the express provision of the charter to the contrary, thus undertake to denude the directors of their statutory authority and rivet on the minority stockholders for all time this perpetual diversion of company profits? Most of all, how could they fasten this burden on the common B stockholders, brought into existence in 1920 only, whose financial interest is twice as large as the common stockholders, but who possess no voting rights? (R. p. 13).

In his dissent, Swan, J., said:

> "Here the directors have exercised no discretion; they rely upon a by-law to relieve them of that duty, and the by-law, as it now operates, results in so large a payment that the trial court thought it probably invalid as applied to future earnings" (R. p. 237).

REASONS III AND IV.

Denial of the right to an equitable revision of total compensation, even if By-Law XII were valid.

These two points are here considered together. Either the trial court, without authority, on a mandate merely reversing an injunctive order against further payments under the by-law pending litigation, denied the petitioner a hearing upon the second branch of his case, to wit, the revision of salaries, and thus denied him due process of law; or the Appellate Court, by affirming this decree dismissing the case upon the merits, notwithstanding the uncontroverted allegations of the complaint, has arrived at the same conclusion. The result in the end is the same, and, however arrived at, is opposed not only to the weight of authority but practically all reported authority.

The province of equity to revise excessive salaries and fix the reasonable compensation of officers is established by a long and unquestioned line of authorities. The following cases were cited in the dissenting opinion of Swan, J. (R. p. 237):

> *Sotter* v. *Coatesville Boiler Works*, 257 Pa. 411;
> *Collins* v. *Hite*, 109 W. Va. 79;
> *Wight* v. *Heublein*, 238 F. 321;
> *Nichols* v. *Olympia Veneer Co.*, 139 Wash. 305;
> *McKey* v. *Swenson*, 232 Mich. 505;
> *Lowman* v. *Harvey R. Pierce Co.*, 276 Pa. 382;

Scott v. *P. Lorillard Co.*, 108 N. J. Eq. 153, aff'd 109 N. J. Eq. 417;
Berendt v. *Bethlehem Steel Corp.*, 108 N. J. Eq. 148;
Stratis v. *Andreson*, 254 Mass. 536;
Ransome Concrete Machinery Co. v. *Moody*, 282 F. 29;
Church v. *Harnit*, 35 F. (2d) 499, 502;
Booth v. *Beattie*, 95 N. J. Eq. 776, aff'd 95 N. J. Eq. 776;
Putnam v. *Juvenile Shoe Corp.*, 307 Mo. 71.

To these may be added the following additional citations:

Mitchell v. *United Box Board & Paper Co.*, 72 N. J. Eq. 580, 585;
Gardner v. *Butler*, 30 N. J. Eq. 702 (Ct. Er. & Appls.);
Lillard v. *Oil Co.*, 70 N. J. Eq. 197, 204;
McMahon v. *Burdette Oil Co.*, 106 N. J. Eq. 79, 80;
Raynolds v. *Diamond Mills Co.*, 69 N. J. Eq. 299, 312;
Godley v. *Crandall*, 153 N. Y. App. Div. 697, 710;
Atwater v. *Elkhorn Co.*, 184 N. Y. App. Div. 253, 258;
Schall v. *Althans*, 208 N. Y. App. Div. 103, 106;
Decatur Land Co. v. *Palm*, 113 Ala. 531, 537;
Backus v. *Finkelstein*, 23 Fed. (2d) 531, 537.

The latest statement approved by the Court of Errors and Appeals in New Jersey in *Booth* v. *Beattie*, 95 N. J. Eq. 776, with reference to this subject, is as follows:

> "It [i. e., the resolution fixing the salaries] is not voidable at the option of a dissenting stockholder as are similar resolutions similarly passed by a board of directors, but it is reviewable in equity as to the fairness and reasonableness of the salary at

> the instance of such stockholder. The rule is that contracts made by a board of directors with one of their number are, regardless of merits, voidable at the option of a dissatisfied stockholder, while such contracts sanctioned by a majority of the stockholders will be set aside by the court if it is disadvantageous to the minority stockholders. Equity will investigate."

Another very clear statement of the rule is in the case of *Sotter* v. *Coatesville Boiler Works*, 257 Pa. 411, 422, cited in the dissenting opinion:

> "Where a board of directors votes excessive salaries to certain of its members who are officers or employees of the corporation, even though such action may subsequently be ratified at a stockholders' meeting, the action of the board is subject to review by a court in equity, and if the finding of the latter tribunal is that the salaries in question are exorbitant, it may determine the value of the services rendered by the officers or employees in question and restrain the corporation from paying the excess thereof."

The textwriters are to the same effect:

> *Fletcher on Private Corporations*, Sec. 2779;
> *Thompson on Corporations*, Secs. 1876, 1877;
> *Spellman on Corporate Directors*, Sec. 225.

Undoubtedly the sound reason for equitable interference in the matter of excessive salaries is that stated in Judge Swan's dissent, that if there is no relation between services rendered and payment made, it really amounts to a gift, "and the majority stockholders have no power to give away corporate property against the protest of the minority." (See also *Collins* v. *Hite*, 109 W. Va., at p. 83). The Court of Appeals in New York speaks of such excess payments as "without consideration" (*Godley* v. *Crandall*, at p. 128).

The principle of these authorities, to which practically none are opposed, was completely disregarded by the judgment below.

Bonus payments of $850,000 for one year, increased fixed salaries, special credits, and stock benefits voted by the directors running for the year 1931 in excess of $2,600,000 for the president alone, with payments to vice-presidents running from $746,000 to $1,587,000 (R. p. 19), were not sufficient, in the opinion of the majority of the Circuit Court of Appeals, to invoke this wholesome remedy. "Individual minority stockholders are not permitted to question the acts of directors * * * if they are done in good faith and in the exercise of honest judgment," say the majority of two Judges, although two other Circuit Judges are not in accord. But were these acts done in good faith and in the exercise of an honest judgment? Can a waste of corporate assets, such as the payment of exorbitant compensation to officers and directors undoubtedly is, be justified upon the ground that it is an act of good faith or sound discretion? The majority opinion says there are no charges of fraud. But fraud, if that be important, is a legal conclusion from facts properly pleaded. In *Godley* v. *Crandall*, 212 N. Y. 121, 132, where a similar contention was made, the Court replied: "But it is plain that the fraud consisted in the officers helping themselves to the funds of the corporation under the guise of salaries voted by themselves." Actual fraud, morover, in the situation here presented, is not controlling. "If a corporation cannot lawfully do a thing, it makes no difference how honestly its officers may attempt to accomplish it" (Bigelow, V. C., in the recent case of *Meyerhoff* v. *Bankers Securities Co.*, 105 N. J. Eq. 76, 84; see also *Mayer* v. *Oxidation Products Co.*, 110 N. J. Eq. 141, 156).

On this application it is not clear how far the petitioner should go into the matter of the separate defenses. The decisions below were not based upon any of these defenses. Nevertheless, they will be briefly reviewed.

SEPARATE DEFENSES.

The first defense is that the petitioner should have combined with two other stockholders and called a meeting to repeal the by-law. The petitioner's contention is that the by-law is invalid, and therefore does not need to be repealed. If valid, the total compensation is still subject to revision, and the principle invoked could not apply.

The second defense sets out that because the petitioner had previously criticized the management, attended the annual meeting of the company April 1, 1931, and voted against Mr. Hill together with holders of some 20,000 shares of stock, that he has ratified this particular transaction involved in a suit commenced March 30, 1931. The allegation that petitioner knew that unless the defendants were re-elected their connection with the company would have been severed is a complete *non sequitur*. There was at this meeting not only no direct ratification of the acts complained of, but not even the remotest implication of any approval or acquiescence in those acts. See, as expressly in point, *Continental Securities Co.* v. *Belmont*, 206 N. Y., at p. 17.

The third defense is the law of the *forum non conveniens*, which has already been discussed in the petition for the certiorari.

The fourth defense is *laches*. But without actual knowledge there can be no laches.

In *Endicott* v. *Marvel*, 81 N. J. Eq. 388, the following statement of the law was approved:

> "Laches is a defense only when the stockholder with a full knowledge of the facts has delayed an unreasonable length of time in bringing his action. These two elements, knowledge and delay, are the essential elements of the defense. Until the stockholder has full and complete knowledge of all the essential facts which would be likely to induce him to institute the action, the beginning of the time from which laches will run cannot be said to com-

> mence. * * * But it is not incumbent on the stockholder to keep himself informed as to the various acts of the corporation. He is not chargeable with knowledge merely because he might have ascertained the facts by an examination of the corporate books. Moreover, it is the well-established rule that lapse of time alone cannot support the defense of laches. There must be both knowledge and delay."

Paragraph 15 of the complaint (R. p. 20) alleges:

> "The plaintiff further avers that the various payments made under said by-law XII to the individual defendants herein were never disclosed to the stockholders of the said company by any official or other communication prior to February, 1931, when the plaintiff as a stockholder made an application to the Supreme Court to examine the books of the said company with respect to salaries and other benefits or payments made by said company to its officers, directors and employees, and that prior to said date he had no knowledge thereof."

Moreover, the wrong here was a continuing wrong (see *Hill* v. *Glasgow R. R. Co.*, 41 Fed. 610, 619 [Opinion by Howell E. Jackson, J.]; and *Lillard* v. *Oil Co.*, 70 N. J. Eq. 197, 211).

Compare *Pollitz* v. *Gould*, 202 N. Y. 11, 17; *Appleton* v. *Am. Smelting Co.*, 65 N. J. Eq. 375.

Federal Courts, moreover, usually apply the doctrine of *laches* in analogy to the statutes of limitations (*Kelly* v. *Boettcher*, 85 Fed. 55, 62; *Backus* v. *Nor. Pac. Ry. Co.*, 21 Fed. [2d] 4, 12), which in New York is ten years (Civ. Pr. Act, Sec. 53). See also *Pollitz* v. *Wabash Ry. Co.*, 207 N. Y. 113, 130.

The fifth separate defense sets forth the accomplishments of the directors in the administration of the company's affairs. But, in *Jacobson* v. *Brooklyn Lumber Co.*, 184 N. Y. 152, 161, dealing with a similar question, the Court of Appeals of New York said:

> "Neither the good faith, honesty, nor legality of the acts of officers of a corporation can be determined by ascertaining whether the market value

> of the capital stock of the corporation has increased or diminished during the time when said acts were performed. A corporation may lose money notwithstanding good, faithful honest endeavor by its officers, and it may increase its assets notwithstanding selfish and illegal acts by them."

See also *Rogers* v. *Guaranty Trust Co.*, 53 Sup. Ct. Rep., at p. 302.

Respectfully submitted,

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